16

No. 85-568

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

NANTAHALA POWER AND LIGHT COMPANY,
TAPOCO, INC., AND ALUMINUM COMPANY
OF AMERICA,

Appellants,

v.

STATE OF NORTH CAROLINA EX REL. UTILITIES COMMISSION,
LACY H. THORNBURG, ATTORNEY GENERAL, *et al.,*

Appellees.

On Appeal from the Supreme Court of North Carolina

BRIEF OF THE NORTH CAROLINA UTILITIES COMMISSION AS AMICUS CURIAE IN SUPPORT OF APPELLEES

WILSON B. PARTIN, JR.
Deputy General Counsel
(Counsel of Record)
NORTH CAROLINA UTILITIES COMMISSION
430 North Salisbury Street
P. O. Box 29510
Raleigh, North Carolina 27626-0510
(919) 733-3969

PRESS OF BYRON S. ADAMS, WASHINGTON, D.C. (202) 347-8203

30PP

TABLE OF CONTENTS

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

No. 85-568

NANTAHALA POWER AND LIGHT COMPANY,
TAPOCO, INC., AND ALUMINUM COMPANY
OF AMERICA,

Appellants,

v.

STATE OF NORTH CAROLINA EX REL. UTILITIES COMMISSION;
LACY H. THORNBURG, ATTORNEY GENERAL, *et al.,*

Appellees.

On Appeal from the Supreme Court of North Carolina

BRIEF OF THE NORTH CAROLINA UTILITIES COMMISSION AS AMICUS CURIAE IN SUPPORT OF APPELLEES

In accordance with this Court's Rule 36, the North Carolina Utilities Commission, an agency of the State of North Carolina, submits this brief as amicus curiae in support of the appellees. All of the parties to this appeal have given written consent to the filing of this amicus curiae brief, and the letters consenting to the brief have been filed with the Office of the Clerk of the Court.

INTEREST OF THE NORTH CAROLINA UTILITIES COMMISSION AS AMICUS CURIAE

The North Carolina Utilities Commission ("NCUC") is interested in this case because it is the decision of the NCUC which is on appeal to this Court from the North Carolina Supreme Court. Appellant Nantahala Power and Light Company is a North Carolina public utility, and its retail rates and service are regulated by the NCUC. Aluminum Company of America ("Alcoa") and Tapoco Inc., have also been determined to be public utilities by the NCUC.

The NCUC is vested with authority under the Public Utilities Act of North Carolina to fix retail rates for all public utilities within the State of North Carolina, including electric utilities. N.C.G.S. Chapter 62. Pursuant to the Public Utilities Act, the NCUC is required to fix just and reasonable rates for public utilities and their customers in North Carolina. The rates approved for the retail ratepayers of Nantahala Power and Light Company in this case effectuate legitimate State interests, in that the NCUC has sought to rectify corporate abuse by the Aluminum Company of America, which is the parent of Nantahala.

STATEMENT OF THE CASE

This case now before the Court began on November 3, 1976, when Nantahala Power and Light Company ("Nantahala") filed an application with the North Carolina Utilities Commission ("NCUC") for an increase of $1,830,791 in its rates and charges for its retail customers in southwestern North Carolina. On June 14, 1977, the NCUC issued an Order granting

Nantahala a rate increase of $1,598,918. This decision was ultimately reversed on appeal by the North Carolina Supreme Court in *State ex rel. Utilities Commission* v. *Edmisten*, 299 N.C. 432, 263 S.E. 2d 583 (1980). The basis for the reversal was the failure of the NCUC to give even minimal consideration to evidence concerning the propriety of treating Nantahala and its affiliate Tapoco, both wholly owned subsidiaries of Alcoa, as a single, unified electric utility and rolling together their properties and costs for retail ratemaking purposes. The North Carolina Supreme Court remanded the case to the NCUC with directions ". . . . to obtain and consider information and data showing what Nantahala's cost of service to its customers would be if the roll-in method of rate making were used and whether Nantahala's customers would benefit thereby." (App. p. 13a)

In the remanded proceeding the NCUC found that Alcoa, Nantahala's parent corporation, and Tapoco, Nantahala's affiliate, were public utilities and joined Alcoa and Tapoco as parties. A panel of three Commissioners held extensive hearings on the issues delineated by the North Carolina Supreme Court. On September 2, 1981, the NCUC Panel issued its Order implementing roll-in upon findings that: (1) Alcoa and Tapoco are North Carolina public utilities; (2) the Nantahala and Tapoco electric facilities constituted a single integrated electric system; (3) the Nantahala and Tapoco systems should be treated as one entity for North Carolina retail ratemaking purposes; (4) Alcoa has dominated Nantahala such that substantial benefits to Alcoa and significant detriment to Nantahala's retail customers have resulted from the New

Fontana Agreement ("NFA") and from the 1971 Apportionment Agreement.

Based upon these findings, the NCUC combined the rate base and expenses of the unified Nantahala-Tapoco electric system, allocated the appropriate costs to Nantahala's North Carolina retail jurisdiction, and set retail rates for Nantahala. The combined Nantahala-Tapoco system costs being lower than the costs of Nantahala as a "stand alone" company, the NCUC reduced Nantahala's rates below the rates approved in the June 14, 1977, Order and required Nantahala to make refunds to its retail customers of the excess rates overcollected since 1977. The NCUC also ordered Alcoa to make such refunds as Nantahala was financially unable to make.

Nantahala, Tapoco, and Alcoa filed exceptions and notice of appeal to the Panel's decision of September 2, 1981. These parties also requested oral argument on their exceptions before the full NCUC. Following oral argument, the full NCUC issued its Order on January 28, 1982, affirming and sustaining in all respects the NCUC Order of September 2, 1981, and overruling the exceptions of Nantahala, Tapoco, and Alcoa.

On appeal by the Companies, the North Carolina Court of Appeals and the North Carolina Supreme Court affirmed the NCUC Orders of September 2, 1981, and January 28, 1982. *State ex rel. Utilities Commission* v. *Edmisten*, 65 N.C. App. 198, 309 S.E.2d 473 (1983); affirmed, 313 N.C. 614, 332 S.E.2d 397 (1985).

From the decision of the North Carolina Supreme Court, the Companies filed Notices of Appeal to the Supreme Court of the United States.

SUMMARY OF ARGUMENT

The NCUC files this brief as amicus curiae in support of the appellees. In their brief the appellees argue that the Orders of the NCUC do not violate the Federal Preemption Doctrine or the Commerce Clause of the United States Constitution.

The NCUC adopts the legal arguments of the appellees and the amicus curiae Town of Highlands, as set forth in their briefs.

The limited purpose of this brief is to set out for the Court what the NCUC decided in this case and why the NCUC decided as it did. The facts of the case are unique in the electric utility industry. Nantahala Power and Light Company is the wholly owned subsidiary of Alcoa. Since the early 1900's Alcoa has developed a power system, which includes Nantahala and Tapoco, in western North Carolina and eastern Tennessee to provide electricity for its aluminum plants in Tennessee. Alcoa's need for electricity is enormous. Alcoa is the largest customer by far of the Alcoa power system. Alcoa has dominated Nantahala and Tapoco for its own benefit as a customer of the Alcoa system and to the detriment of the retail customers of Nantahala.

The decisions of the NCUC have sought to rectify this corporate abuse. In setting rates for Nantahala and its retail customers, the NCUC employed accepted methodologies of jurisdictional and cost allocations. The NCUC sought neither to impinge upon the authority of the Federal Energy Regulatory Commission nor to place an impermissible burden on interstate commerce.

Despite the many attempts to characterize this case in Federal preemption terms, this is not a case about North Carolina versus Tennessee hydroelectric power. This is not a case about "first call." This case has nothing to do with whether power is generated in North Carolina or Tennessee.

It is essential to an understanding of the case that one understands the major role played by Alcoa, the parent of both Nantahala and Tapoco. The Appellants, as well as many of the *amici curiae* before this Court, have laid great emphasis on Alcoa, the customer. However, the NCUC dealt with Alcoa in Alcoa's primary role as the sole stockholder of Nantahala and Tapoco, and its manipulation of these two utilities for its own selfish interest, to the detriment of the customers of Nantahala. It was immaterial that one of these subsidiary utilities happened to be in the State of Tennessee. It is critical to recognize that any refund required to be paid was assessed against Alcoa-the-parent; Alcoa is a Pennsylvania corporation, and if refunds are required from it, the stockholders of Alcoa (the parent), wherever located, would be responsible for the payment of those refunds. There were no assessments against Tapoco or Alcoa-the-customer, and the NCUC nèver attempted to move one kilowatt of power from Tennessee to North Carolina or award any monetary damages which would affect our sister State, Tennessee.

If the Court will view Alcoa as the parent, the sole stockholder of Nantahala, the manipulator of its two puppet subsidiaries, Nantahala and Tapoco, it will have an understanding of the true significance of this case.

ARGUMENT

The Order of the NCUC issued September 2, 1981, made the following findings of fact:

1. Nantahala and Tapoco are public utilities under North Carolina law and are subject to the jurisdiction of the NCUC with respect to retail rates and service.

2. Both Nantahala and Tapoco are wholly owned subsidiaries of Alcoa.

3. Alcoa, the 100% owner of Nantahala and Tapoco, is a public utility under North Carolina law by virtue of its effect on the rates and service of Nantahala and Tapoco. N.C.G.S. 62-3(23)c.

4. The Nantahala and Tapoco electric facilities constitute a single, integrated electric system and are operated as such by, and as a coordinated part of, the Tennessee Valley Authority (TVA) system.

5. For purposes of setting Nantahala's rates in the proceeding, the Nantahala and Tapoco systems should be treated as one entity with respect to all matters affecting the determination of Nantahala's reasonable cost of service applicable to its North Carolina retail customers.

6. The New Fontana Agreement ("NFA"), executed by TVA, Alcoa, Nantahala and Tapoco, and the resultant 1971 Apportionment Agreement between Nantahala and Tapoco, have resulted in substantial benefits to Alcoa to the significant detriment of Nantahala's customers.

7. The roll-in methodology employed by the Intervenors [who represented the customers of Nantahala] should be used by the NCUC in making jurisdictional cost allocations and cost-of-service allocations.

8. Alcoa has so dominated certain transactions and agreements affecting its wholly owned subsidiary, Nantahala, that Nantahala has been left but an empty shell, unable to act in its own self interest, let alone in the interest of its public utility customers in North Carolina. (App. pp. 175a-179a).

Based upon these findings, the NCUC determined the rate base and expenses of the single Nantahala-Tapoco system, allocated the combined system costs between the retail public load in North Carolina and the industrial load of Alcoa in Tennessee, and set retail rates for Nantahala which resulted in a rate reduction from the retail rates approved in 1977. Nantahala was ordered to refund the excess rates it had collected from its retail customers. Alcoa was ordered to refund those amounts of excess revenues that Nantahala was financially unable to make. (App. pp. 233a-235a).

In its final Order entered on January 28, 1982, the NCUC overruled the exceptions of Alcoa, Nantahala, and Tapoco to the September 2, 1981, Order and made supplementary conclusions of law with respect to certain federal questions raised by the Companies in the oral argument before the full Commission. The NCUC concluded that the Order did not conflict with the exclusive federal licensing authority of hydroelectric power under Part I of the Federal Power Act, nor with the preemptive jurisdiction of FERC to regulate interstate wholesale electric rates; nor did the Order impose an unreasonable burden on interstate commerce. (App. pp. 237a-247a).

The Factual Basis of the NCUC Order: History and Development of the Integrated Alcoa Power System

The NCUC regulates four major electric utilities with respect to retail rates and service, including Nantahala Power and Light Company. Nantahala is unique among these companies, as an examination of the evidence before the NCUC will disclose. An understanding of the decision of the NCUC requires an examination of the electric power system in western North Carolina that was developed by Nantahala's 100% owner, Alcoa. The decision of the North Carolina Supreme Court and the Order of the NCUC of September 2, 1981, set out in detail the development of the Alcoa power system. (App. pp. 18a-32a) The facts may be summarized as follows:

In the early 1900's Alcoa came to the western North Carolina mountains to develop low-cost hydroelectric power for its aluminum reduction plant in Alcoa, Tennessee. As its source of hydroelectric power Alcoa acquired two public utilities, Tallassee Power Company ("Tallassee," later Carolina Aluminum, Inc., and now Yadkin, Inc.) and Knoxville Power Company (later Tapoco) in Tennessee. Tallassee owned several hydroelectric sites along the Little Tennessee River in North Carolina. By the 1920s Alcoa, through its subsidiaries, had acquired a substantial number of hydroelectric sites along the Little Tennessee River in North Carolina and Tennessee. Alcoa developed these sites primarily for the purpose of producing and transmitting electricity to its Alcoa, Tennessee, aluminum plant. (App. p. 18a)

In 1929 Alcoa created and incorporated Nantahala as another of its wholly owned subsidiaries in North Carolina. Nantahala was franchised as a North Carolina public utility to serve a six-county area in southwestern North Carolina. In time, Tallassee sold its undeveloped North Carolina sites to Nantahala, including the Fontana Dam site later developed by TVA. Between 1929 and 1941 Nantahala undertook token public service. In 1941 Nantahala obtained a certificate from the War Department to develop the Nantahala and Glenville projects on the upper reaches of the Little Tennessee watershed. Nantahala's stated justification for these projects was the huge electricity needs of Alcoa's aluminum plants in Tennessee. In its application for the certificate, Nantahala repeatedly referred to these projects as part of "the Alcoa power system" or "the system." (App. p. 19a).

Prior to 1941 both Nantahala and the Tennessee Valley Authority (TVA) were interested in developing a large hydroelectric site at Fontana on the Little Tennessee River in North Carolina. The project was to generate electricity both for Alcoa's aluminum production and for use by the public. Following a determination by the Federal Power Commission that the project would require a license from that agency under Part I of the Federal Power Act, Nantahala abandoned the project. (App. p. 19a).

In 1941 Alcoa and TVA entered into the Original Fontana Agreement ("OFA"). Nantahala was not a party to the agreement. Pursuant to this Agreement, Alcoa caused Nantahala to transfer the Fontana Dam site to TVA. The Agreement required the Alcoa system companies to convey the output from their generating plants to TVA in return for TVA power and

energy entitlements. The level and amount of power entitlements were dependent on the level of generation TVA controlled. In exchange for the companies' relinquishment of control over stream flow and production, TVA provided compensation power of 11,000 kW to the Alcoa system. During its 20-year term the OFA was never filed with the FPC as a tariff or rate schedule nor was its lawfulness ruled upon by the FPC. (App. pp. 20a-22a).

In October 1954 Nantahala and Alcoa entered into a contract which required Nantahala to make its excess power available for Alcoa's Tennessee plants and required Alcoa to provide power for Nantahala when Nantahala could not meet its public service load. At this time Nantahala's capacity and energy production were far in excess of its public service load. Nantahala's excess entitlements under the OFA were sold to Alcoa at "dump" prices. (App. pp. 21a).

In October 1954 Alcoa's wholly owned subsidiary, Knoxville Power, changed its name to Tapoco. Tapoco was then domesticated as a North Carolina corporation. (App. p. 24a).

In October 1954, Tapoco and its affiliate, Carolina Aluminum Company, filed a joint application with the FPC for a license to operate the "Tallassee project" along the Little Tennessee River in North Carolina and Tennessee. The joint application stated that the energy from the Tallassee project "is and will continue to be delivered to the Tennessee Valley Authority, which in turn delivers an equivalent amount of energy to the Aluminum Company of America at Alcoa, Tennessee, pursuant to the provisions of the Fontana Agreement and the supplemental agreement thereto dated August 14, 1941, and October 13, 1954,

respectively." The joint application also stated that after the exchange of energy between TVA and the Alcoa system pursuant to the Fontana agreement, "[a]ll the energy is used for aluminum production except for a small portion used for lighting in operators' villages." (App. p. 24a).

In 1955 Tapoco applied to the NCUC for a certificate of public convenience and necessity. This certificate is still in effect and has never been abandoned or modified. The certificate required Tapoco to supply power to Nantahala for the villages of Santeetlah and Tapoco, North Carolina. In 1955 Tapoco sold its Tennessee electric distribution system to the City of Alcoa and thereby freed itself of its Tennessee public load. Consequently, Tapoco's share of the TVA return power was devoted exclusively to Alcoa's aluminum production facilities. (App. pp. 25a-26a).

During the period 1941-1960 Nantahala sold over 80% of its total generating power to Alcoa at a price which was less than the cost of producing and distributing it. Yet Nantahala derived the greater part of its revenue from customers other than Alcoa, who consumed only 18% of its power and who were charged approximately twice as much per kWh as Alcoa was charged. The North Carolina Supreme Court determined that this sale at "dump prices" to Alcoa resulted in discrimination against Nantahala's retail customers. (App. pp. 26a-27a).

During the period 1950-1955 Nantahala expanded its facilities to provide additional power to Alcoa to meet Korean War aluminum demand. Nantahala has added no generating capacity to its system since 1957, notwithstanding its public load has increased. (App. p. 26a).

In 1960 Alcoa and TVA began the renegotiation of the Original Fontana Agreement. At the same time, Nantahala and Duke Power Company began negotiations whereby Nantahala would sell its distribution system to Duke while retaining its generating facilities. If the sale had been effected, Nantahala would have been allowed to abandon its public utility load. In 1963 the North Carolina Supreme Court reversed the NCUC's approval of the sale. (App. pp. 28a-29a).

The New Fontana Agreement (NFA), which took effect in January 1963, modified and partially superseded the OFA. Nantahala was a signatory to the NFA although it did not participate in the negotiations between Alcoa and TVA. Under the NFA there were the same mechanics of power coordination and exchange as in the OFA. TVA dispatched the operations of Tapoco's four plants and eight of Nantahala's largest plants and received all of the electrical output thereof. In return Nantahala and Tapoco would receive power entitlements from TVA, to be divided between the two companies as they saw fit. (App. pp. 28a-29a).

The NFA allowed Nantahala and Tapoco to divide the power from TVA as they saw fit. In 1963 the Alcoa-Nantahala Apportionment Agreement provided that Nantahala was to receive each month a variable of the larger of one-twelfth of its annual primary energy capability of 360 million kWh or its actual generation (which was 424 million kWh annually). The 1963 Agreement fixed no capacity or demand limitation upon Nantahala's use of the energy returned. Alcoa was to pay Nantahala the sum of $89,200 annually as compensation for allowing TVA to operate Nantahala's projects. Unlike the 1954 Alcoa-Nanta-

hala Agreement under the OFA, the 1963 Agreement did not require Alcoa to satisfy any power deficiency experienced by Nantahala in meeting its public load. (App. p. 30a).

By 1971 Nantahala's public load had grown to the point where it had no more excess energy to sell to Alcoa. To meet the needs of its growing public load, Nantahala looked to TVA. At the urging of TVA, Nantahala and Tapoco executed the 1971 Apportionment Agreement, in which Nantahala's share of the NFA power entitlements was fixed at 360 million kWh annually, which was its primary energy capability. Nantahala entered into a contract to purchase additional power from TVA. As a result of this agreement, Nantahala was required to pay a charge for the demand of its system above 54,300 kW at any instant. The 1971 Agreement did not retain the provision in the 1963 Agreement whereby Alcoa paid Nantahala $89,200 annually in compensation for TVA's control of Nantahala's facilities. The 1971 Apportionment Agreement was not filed with the FPC until 1980. (App. pp. 30a-31a).

Since 1971 Nantahala's return power entitlements from TVA have not been sufficient to meet its public load, even though its actual generation exceeded its public load during the 1975 test year. As a result, Nantahala has had to purchase higher cost power from TVA. (App. p. 32a).

Based upon the evidence before it, the NCUC found and concluded that the Nantahala-Tapoco electric facilities constitute a single integrated electric system and should be considered as such for retail ratemaking purposes. In so deciding, the NCUC considered the following evidence: Nantahala and Tapoco are both

wholly owned subsidiaries of a single corporate parent, Alcoa. The electric facilities of Nantahala-Tapoco are mostly located on the Little Tennessee River and its tributaries in western North Carolina. The Nantahala and Tapoco facilities are located in contiguous areas and are physically interconnected with each other. Both companies are interconnected with TVA. Power can be dispatched and transmitted from the facilities of one to the facilities of the other. The Original Fontana Agreement and the New Fontana Agreement, both of which were negotiated with TVA by Alcoa, treat the facilities of Nantahala and Tapoco without discrimination and make them an integrated part of, and subject them to coordination by, the TVA system. Pursuant to these agreements TVA receives the output of all of the hydro resources of both Nantahala and Tapoco, except for three small units of Nantahala. These agreements also required Tapoco and Nantahala to turn over to TVA the control of production and stream flow. Accordingly, TVA determines for Tapoco and Nantahala, as a single entity, both electric generation and stream flow and operates them as a coordinated part of TVA's own system. In turn, Tapoco and Nantahala jointly receive back from TVA certain entitlements of power which they divide between themselves by the 1971 Nantahala-Tapoco Apportionment Agreement. (App. pp. 41a-44a; 180a-182a).

Nantahala was designed to operate as an integral part of a larger utility system, and its projects were developed in accordance with Alcoa's aluminum production needs rather than the needs of its public load. In fact, the greater part of Nantahala's capacity was added before there was a significant public load. Since

the mid-1950s no significant capacity has been added despite the continued growth of Nantahala's public load. (App. p. 42a).

The Benefits to Alcoa and the Detriment to Nantahala and to Nantahala's Retail North Carolina Customers Resulting from the Domination by Alcoa of the Integrated Power System.

The NCUC found that Alcoa has so dominated Nantahala that Nantahala was unable to act in its own self interest or in the interest of its public utility customers in North Carolina. Because of this corporate dominance, the various agreements executed by Alcoa with TVA, and among Alcoa, Tapoco, and Nantahala, resulted in substantial benefits to Alcoa and significant detriment to Nantahala. The agreements show that the power system developed by Alcoa since the early days of the 20th century was designed to benefit primarily the needs of the Alcoa aluminum plants in eastern Tennessee.

These benefits and detriments were discussed by the NCUC in detail. The North Carolina Supreme Court summarized them as follows:

> In some twenty pages of its rate reduction order, the Commission exposed and "fleshed out" the extensive network of detriments and inequities to Nantahala and its customers embedded in the terms of the NFA and 1971 Apportionment Agreement. In essence, the Commission found that a disproportionate amount of the capacity and energy resources of the combined Nantahala-Tapoco system, perfectly usable by the load characteristics of the Nantahala public load, were traded away to reform the TVA return entitlements to fit the needs and characteristics of an aluminum smelting and fabrication operation. Because Nantahala is structured, operated, and treated as an integral unit of the combined system, rather than as a stand-alone company, the detriments it incurs under the integrated system's power supply contracts result in concealed benefits flowing to Tapoco, and ultimately to its parent and sole customer, Alcoa. While "costs" charged to the combined system under these contracts might be considered objectively fair and reasonable from the wholesale perspective, the public customers of Nantahala were found to have fared badly when that utility was artificially separated out of the unified system for allocation purposes, and then forced to bear the added responsibility for costs of purchased power from TVA. (App. p. 57a).

1. Concealed Benefits of the 1971 Apportionment Agreement

A full discussion of the detriments to Nantahala and the benefits to Alcoa arising out of the NFA and the 1971 Apportionment Agreement may be found in the Order of the NCUC. (App. pp. 182a-205a). For example, the NCUC found that, under the 1963 Agreement, Nantahala received annually an average of 426 million kWh as NFA energy entitlements. There was no demand limitation on Nantahala's use of its return power entitlements. Under the 1971 Agreement, however, which was devised by Alcoa power consultant, George Popovich, Nantahala received only 360 million kWh annually. Consequently, Nantahala was deprived of an average of 66 million

kWh annually. The NCUC concluded that this "detriment to Nantahala constitutes a benefit to Tapoco that is passed on to Alcoa." (App. p. 185a).

With respect to the quantity of Nantahala's peaking capacity: the 1963 Agreement placed no demand limitation on Nantahala's use of its return power entitlements. Under the 1971 Agreement, as devised by Mr. Popovich, Nantahala was assigned a peaking capacity of 54,300 kW, although a 1960 study had computed Nantahala's capacity at 85,400 kW under the most adverse water conditions. As a result, anytime that Nantahala provided a customer demand in excess of 54,300 kW, it paid a monthly demand charge to TVA for all power over that limitation. The NCUC found Nantahala's actual capacity to be 81,800 kW. The NCUC concluded that "[d]emand costs imposed on Nantahala for use of capacity between its assigned capacity of 54,300 kW and its actual capacity of 81,800 kW, would represent an expense to Nantahala and, thus, a savings to its New Fontana Agreement sister, Tapoco, since the capacity constraints for the TVA return entitlements are jointly shared by them under the New Fontana Agreement. Tapoco's savings are passed on to Alcoa so as to become Alcoa savings, i.e., a concealed benefit." (App. p. 186a).

The NCUC also determined that the 1971 Apportionment Agreement gave no credit for Nantahala's upstream benefits to Tapoco, which arise from the fact that water stored by Nantahala upstream can be released to flow downstream and be used by Tapoco for the production of electricity. The NCUC computed the value of this benefit at 37,668,000 kWh annually as an upstream benefit from Nantahala to Tapoco. Under the 1971 Agreement, Nantahala received no

credit for this benefit to Tapoco, which accrued to Tapoco and, in turn, to Alcoa. (App. pp. 189a-190a).

The NCUC further found that the 1971 Apportionment Agreement as devised by Alcoa consultant Popovich did not consider the proper value to Nantahala of the fact that the Nantahala, Tapoco and TVA systems are interconnected. The NCUC Order stated:

> . . . Interconnection is of considerable value to TVA completely aside from the fact that Nantahala's rate base includes in it certain assets devoted to the interconnection, which assets are entitled to earn a rate of return. Because Nantahala is not an isolated system, it should be receiving the usual benefits that accrue from coordinated operation. Yet, Nantahala does not receive the usual benefits of an interconnected and coordinated system. (App. p. 193a).

In reaching this determination, the NCUC relied on Alcoa documents, introduced by the customers, which revealed Alcoa's recognition of the value to TVA of the integrated operations. For example, one Alcoa memorandum stated:

> There is a strong feeling among the Engineering Department, particularly Messrs. Gnuse, Tompkins, Eagleton, Popovich and others, that the value to TVA of integrated operation is much greater in 1960 than it was in 1941 at the time the contract was negotiated. They have argued that because of this, TVA should be willing to renegotiate

> the entire Fontana Agreement recognizing the present inequities. . . (App. p. 194a).

The NCUC calculated that Nantahala's upstream benefit to TVA was 70,956,000 kWh. Nantahala received no credit for this benefit in the 1971 Agreement.

The NCUC summarized the detriment to Nantahala from the 1971 Apportionment Agreement by totaling the annual kWh which Nantahala contributed to the combined power system and for which no credit was given. The NCUC determined that Nantahala was deprived of 200,224,000 kWh annually. The NCUC further noted that Nantahala "received no credit for its peaking capacity of 27,500 kilowatts over the 54,300 kilowatts assigned to it, for which Nantahala must pay demand charges to TVA when monthly demand exceeds assigned capacity." (App. p. 196a).

The NCUC concluded:

> Now that considerably more of the various detriments to Nantahala have been exposed and fleshed out, it is apparent that the 1971 Apportionment Agreement works an extensive injustice on Nantahala and its public ratepayers, the gravity of which far exceeds even that envisioned by the [North Carolina] Supreme Court. (App. p. 197a).

2. Concealed Benefits of the New Fontana Agreement

A full discussion of the concealed benefits flowing from Nantahala to Alcoa by virtue of the New Fontana Agreement may be found in the NCUC's Order of September 2, 1981, (App. pp. 197a-215) and in the opinion of the North Carolina Supreme Court (App. pp. 63a-65a). In summary, the NCUC found these concealed benefits to be "entirely different" from the

benefits of the 1971 Apportionment Agreement. The NCUC Order stated:

> The basic inequity to Nantahala arising out of the NFA is that the energy entitlement returned to Nantahala and Tapoco from TVA is structured to meet Alcoa's demand for a certain amount of stable electricity for purposes of aluminum production rather than a demand for a public load. Consequently, the NFA returns an average of 218,300 kilowatts of energy at a high load factor with minimal peaking deviation, which load is principally designed to service Alcoa's pot-lines and other production electrical requirements. Even the interruptible and curtailable energy entitlement returned to Tapoco-Nantahala is in increments of wattage that conform to the demands of a pot-line so that, if power is interrupted or curtailed, Alcoa can respond by cutting out a particular pot-line. (App. p. 197a).

The NCUC compared the demand of Alcoa with that of Nantahala. Nantahala has the fluctuating demand for energy which has peaks and valleys and which is typical of a public service load. The NCUC noted that Nantahala needed peaking capacity and that its generation projects had that capacity, but that such peaking capacity was traded away to TVA by the New Fontana Agreement. (App. p. 198a). The evidence further showed that Alcoa reaped "enormous benefits" through the improvement of the availability of Tapoco's secondary energy production from a level of 42% average curtailment to an average curtailment rate of only 8%. (App. 198a).

Alcoa was in direct control of the negotiations with TVA that resulted in the New Fontana Agreement. (App. p.198). The NCUC examined the reasons why the NFA was designed so exclusively to meet Alcoa's needs, to the detriment of Nantahala's public load. It concluded that during the NFA negotiations between Alcoa and TVA the parties contemplated the sale of Nantahala's distribution system to Duke Power Company. "By the sale to Duke, Nantahala would have been left with its generation but would have been without a public service load. Nantahala would then have taken its NFA entitlement and delivered it all to Alcoa. Accordingly, the power Nantahala would have gotten under the NFA would have been satisfactory for delivery to Alcoa irrespective of quantity and design." (App. pp. 198a-199a). The NCUC approved the sale to Duke, but this Order was reversed by the North Carolina Supreme Court in 1963 and the sale never took place. By the time the North Carolina Supreme Court handed down its decision, the NFA had been executed. The NFA was never modified or amended, however, to take into account that the sale to Duke did not take place.

The Roll-In and the Allocation Methodologies

Having determined that Nantahala and Tapoco constitute a single, integrated power system, the NCUC then proceeded to set reasonable rates for Nantahala by employing the roll-in methodology, whereby the rate base, revenues, and expenses of Nantahala and Tapoco were added together, and the combined system assigned the rate of return approved for Nantahala alone in the 1977 proceeding. Next, the combined system cost of service was allocated between the public load customers in North Carolina

and the industrial load customer (Alcoa) in Tennessee. The allocation methodology proposed by the Companies assigned customer costs by using the entitlements of the New Fontana Agreement and the 1971 Apportionment Agreement. The methodology proposed by all of the intervenors, including the Attorney General, allocated cost responsibility to the Nantahala retail public load on the basis of the percentages of the combined system's power and energy resources, including Nantahala's TVA purchases, required to serve that load. (App. p. 55a).

The NCUC concluded that the inequities arising out of the New Fontana Agreement and the 1971 Apportionment Agreement should not be used as a basis for cost allocation and rejected the Companies' allocation methodology. The NCUC stated in its order:

> Summarizing the foregoing inequities to Nantahala which result from the New Fontana Agreement, it can be stated that the TVA return entitlement was entirely designed for Alcoa's industrial load and was not suitable for Nantahala's public service responsibilities. Nantahala needed peaking capacity and had peaking capacity from its own generating stations, yet Nantahala gave up that capacity with the result that it must buy high cost power from TVA to meet its peaking responsibilities. The extra costs thus incurred by Nantahala inure to the benefit of Alcoa. For instance, by the 1963 Alcoa-Nantahala Apportionment Agreement, even Alcoa recognized, in fact, the unfairness to Nantahala produced by the NFA and agreed to pay an annual cash settlement of $89,200,

to Nantahala to offset some of the inequities. (App. p. 202a).

The NCUC adopted the cost allocation methodology propounded by the intervenor customers. The methodology used by the NCUC was neither unique nor revolutionary, but is traditionally employed by the NCUC in apportioning the total system costs of any multijurisdictional investor-owned electric utility, e.g. Duke Power Company or Carolina Power & Light, both of which provide wholesale and retail service in two states.

Of critical importance was the inclusion or exclusion of Alcoa's power purchases from TVA in the combined system cost of service. The NCUC accepted the contentions of the intervenor customers that the direct industrial purchases that Alcoa made from TVA were not properly a utility function of either Tapoco, Nantahala, or the combined utility system of both, and therefore was not properly includable in the cost of service allocation. These purchases, which amounted to $31 million, were allocated entirely to Alcoa. In deciding to exclude these purchases, the NCUC determined that the TVA power purchased by Alcoa was not integrated with the combined electric system. The evidence showed, for example, that the TVA power never entered the combined system. The evidence showed, at most, that if Tapoco had any contact with the TVA purchases, such contact amounted only to transforming and switching. The TVA power retained its identity as Alcoa power. (App. p. 211a).

In support of its decision to exclude the TVA purchases from the combined system costs, the NCUC examined the contract between TVA and Alcoa for the power purchases. The NCUC found that the terminology of the contract was not suitable for a public utility load, which needs variable amounts of energy, but rather was suitable only for a specific industrial customer having stable needs. (App. p. 214a).

The NCUC Order stated:

> Alcoa is a gigantic energy consuming entity nationwide and its impact on western North Carolina is likewise enormous. If the Alcoa, Tennessee, load that is purchased from TVA were to be assigned as a function of the Nantahala-Tapoco system, the impact of that load on the system would be so enormous as to warp and twist the costing technique of the entire system. Indeed, if the Nantahala-Tapoco system tried independently to service the Alcoa-Tennessee load, it would have to double its system size. Yet no effort has been made by the system to do that. Neither Nantahala or Tapoco has built a facility in over 20 years. Alcoa is entirely dependent upon TVA for its supplemental load. (App. p. 215a).

The primary cost allocation issues specifically concerned the development of appropriate demand and energy cost allocation factors. In summary, the Commission concluded that 24.60% of all Nantahala-Tapoco unified system demand related costs and 24.51% of all Nantahala-Tapoco unified system energy costs should be assigned to the system's North Carolina retail operations. (App. pp. 215a-221a).

The Rate Reduction and the Liability of Alcoa

Having found that Alcoa's dominance of its wholly owned subsidiary resulted in substantial benefits to

Alcoa and significant detriment to Nantahala and its retail ratepayers, the NCUC Order of September 2, 1981, reduced Nantahala's rates to reflect the cost of service of the combined system, required refunds to Nantahala's customers of the excess rates collected by Nantahala from its customers, and required Alcoa to make the refunds to the extent that Nantahala was financially unable to do so. In so deciding, the NCUC sought to fix just and reasonable rates for Nantahala and its retail customers and to rectify the corporate abuse by Alcoa of its power system in western North Carolina.

In imposing the refund obligation upon Alcoa as well as Nantahala, the NCUC "pierced the corporate veil" to hold the parent Alcoa responsible for its detrimental dominance of the Alcoa power system. Alcoa's single-minded development of the hydropower sites in western North Carolina resulted in Alcoa's assigning exclusively to itself the least expensive power of the system, while the more expensive power was relegated to Nantahala's public load. The adverse impact on Nantahala's retail rates was enormous.

CONCLUSION

The North Carolina Utilities Commission never changed any rate set by the Federal Energy Regulatory Commission. The North Carolina Utilities Commission Order never moved one kilowatt of power from Tennessee to North Carolina or caused any rate for electric power to change in Tennessee. The North Carolina Utilities Commission simply exercised its power and duty to set fair rates for North Carolina retail customers. Choosing the appropriate allocation method of the roll-in for Nantahala is comparable to

using the summer coincident peak allocation method in North Carolina Duke rate cases, whereas, the Federal Energy Regulatory Commission uses the twelve-month coincident peak. Neither methodology interferes with FERC's exclusive jurisdiction under the Federal Power Act.

This case is unique because Alcoa-the-parent totally manipulated its wholly owned subsidiary Nantahala. The manipulation resulted in vast benefits to the parent and substantial detriment to the retail customers of Nantahala. The case simply requires Alcoa-the-parent to be responsible for the refunds because Alcoa-the-parent was responsible for the unjust charges to Nantahala's customers.

As pointed out in the amicus brief of New England Electric System (NEES), Alcoa is not a typical electrical utility holding company. In fact NEES takes pains to point out that Alcoa may not adequately present the view of other utility holding companies "because Alcoa's primary business is not as an electric utility and it is not subject to comprehensive regulation under the Holding Company Act, the Federal Power Act, and state utility law as are NEES and its subsidiaries." Because of Alcoa's domination and manipulation of its two utility subsidiaries, it is necessary to find that there is only one unified electric system and that the roll-in is the proper mechanism to allocate that system's costs.

For the reasons stated, the decision of the North Carolina Supreme Court below should be affirmed.

Respectfully submitted,

WILSON B. PARTIN, JR.
Deputy General Counsel
(Counsel of Record)
NORTH CAROLINA UTILITIES COMMISSION
430 North Salisbury Street
Post Office Box 29510-Dobbs Building
Raleigh, North Carolina 27626-0510
(919 733-3969